In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 371

EDWARD J. McCARTHY AND LORA R. McCARTHY,
PETITIONERS

v.

JOSEPH J. CONLEY, DISTRICT DIRECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF CONNECTICUT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

After the death of petitioner's[1] mother in 1931 she and her four brothers and sisters owned all of the stock of the family corporation (Oyster Corporation) (Pet. App. 2a–3a; Pet. 3). In December 1954, petitioner's 20% stock interest was redeemed by Oyster Corporation in exchange for an amount of cash which was less than her basis in the stock (Pet. App. 14a, n. 17). The Commissioner disallowed petitioner's claimed deduction for the loss. She paid the resulting deficiency and sued for a refund. The district court

[1] Petitioner's husband is a party solely because he and his wife filed joint returns.

784-872—65

denied her claim and the court of appeals affirmed (Pet. App. 2a).

Section 267(a)(1) of the 1954 Code disallows losses suffered in the sale of property to a related party. It is undisputed that because petitioner and her brothers and sisters owned all the stock of the family corporation, she and Oyster Corporation were related parties as defined by § 267 (Pet. App. 3a). Petitioner's loss is thus disallowed unless she falls within the statutory exception for losses resulting from "distributions in corporate liquidations" (§ 267(a)(1) of the 1954 Code). While it is quite clear that the redemption of petitioner's stock was a "distribution" (§ 302(a)), the statutory language and the purpose of § 267 and the exception make it equally clear that the redemption in the instant case was not a "corporate liquidation."

Two sections of the Code define the term liquidation. Petitioner does not claim that the instant transaction falls with § 331's definition of a "complete liquidation." And the lower courts quite correctly rejected petitioner's contention that the redemption of her stock constituted a "partial liquidation" under § 346, since they found as a question of fact that there was no "corporate contraction." S. Rep. No. 1622, 83d Cong., 2d Sess., 262; see Treasury Regulations § 1.346–1(a). (Pet. App. 12a–15a.)[2]

[2] Taxpayer cites § 115(i) of the Internal Revenue Code of 1939 as evidence that any redemption constitutes a partial liquidation. Since in enacting the 1954 Code, which governs this case, Congress dubbed § 115(i) "incoherent" and drastically revised it (S. Rep. No. 1622, 83d Cong., 2d Sess., 49; 3 U.S. Code

Moreover, such a construction furthers § 267's purpose. This Court has stated (*McWilliams* v. *Commissioner*, 331 U.S. 694, 700) that § 267 was designed:

> to put an end to the right of taxpayers to choose, by intra-family transfers and other designated devices, their own time for realizing tax losses on investments which, for most practical purposes, are continued uninterrupted.

Here the family group's control of Oyster Corporation continued uninterrupted after the redemption of petitioner's stock just as it had before. If petitioner had sold her stock to one of her brothers or sisters, § 267 would have prohibited her from recognizing the loss (§ 267 (a)(1), (b)(1), (c)(4)). Selling her stock directly to Oyster Corporation, which was then wholly owned by her brothers and sisters, could produce no different result. In either event the transfer had no effect on the family's control of Oyster Corporation.

The purpose of the exception for losses on distributions in corporate liquidations is also quite clear. If the corporation had actually sold a substantial portion of its facilities, or otherwise contracted its corporate business, the position of the family group as a whole would have been changed, and the recognition of loss would have been appropriate. Since the lower courts found that there was no corporate contraction in this case the exception to § 267 is inapplicable.

Cong. & Adm. News, p. 4680 (1954); authorities cited in Petitioner's Appendix 6a–7a and n. 12), we believe it unnecessary to present lengthy rebuttal.

The decision of both lower courts was correct, and there is no conflict with any other decided case. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

RALPH S. SPRITZER,
Acting Solicitor General.
JOHN B. JONES, JR.,
Acting Assistant Attorney General.
DAVID O. WALTER,
JONATHAN S. COHEN,
Attorneys.

AUGUST 1965.

U.S. GOVERNMENT PRINTING OFFICE: 1965